BASIC GUIDE TO COMPENSATION FOR PENSION LOSS

A: INTRODUCTION

Some cases in the Employment Tribunal (ET) can lead to an award of compensation for loss of pension. These are cases where the employer's unlawful action (usually dismissal[1]) causes a loss of pension contributions or a reduction in the value of pension benefits.

Unlike loss of earnings, loss of pension is not obvious at the point of dismissal. Many claimants may not realise that pension loss arises at all. Others will recognise that they are likely to suffer from pension loss, but have little idea how to put a value on that loss. Employers and their representatives can also find it difficult to put a value on pension loss. It is a complicated subject.

Before the ET makes its decision, both sides have a right to put forward arguments about how much to award. They can't do that without some understanding of the principles involved. It is also helpful for the parties to be able to understand at a much earlier stage what that decision might be, so that they have a better chance of reaching agreement on the award.

To help ETs, representatives and parties calculate the approximate value of pension losses (without individual advice from pensions professionals) a guidance document called "**Principles for Compensating Pension Loss**" has been produced by a team of Employment Judges. The latest version can be found on the ET Practice Direction website here for England and Wales, and here for Scotland, and is referred to below as "the Principles".

The Principles is a long and complex document. It needs to be; pension calculations can be complicated and there are lots of different circumstances and scenarios. However, its complexity means that some people may find it difficult to use.

This document has been produced by the same team of Employment Judges. Its aims are:

(a) to help claimants and respondents understand when pension loss might arise and how it will be approached;

[1] Other actions, such as a discriminatory failure to promote, can cause pension loss but this Guide will concentrate on dismissals.

(b) to help representatives to understand which parts of the Principles might apply to the case they are involved in, and

(c) to make the Principles more accessible to anyone trying to put a value on pension loss at an early stage of the claim.

By its nature, this document is a simplification. There is much more information in the Principles, and a point which is important in your case may be included in the Principles but not mentioned here. Nevertheless, we hope this Basic Guide will be a helpful starting point.

B WHAT SORT OF PENSION LOSS?

State pension

For most claimants, a period of unemployment will not stop them from making the 35 years of National Insurance contributions that they need to secure a full state pension (known as the New State Pension or nSP). That means that loss of state pension will not be in issue in most ET cases. For cases where it might arise, there is further information about the state pension and about calculating losses in Chapter 3 of the Principles.

Occupational pensions

This Guide is mainly concerned with losses related to occupational pensions – a pension scheme which an employee is enrolled into because of the job that they do (including through auto-enrolment, which now covers most workers).

Occupational pensions fall into two main types:

Defined contribution (DC): in these schemes the employer and employee each contribute a defined percentage of pay into a pension pot. On retirement, the money in the pot is used to buy pension benefits. The value of the pension itself is not set before retirement (although employees may be given estimates). Most private sector schemes, particularly newer schemes, are defined contribution schemes.

Defined benefit (DB): in these schemes the employee is entitled to a defined pension at retirement calculated by a formula which uses their earnings and length of service. 'Final salary' pensions are a type of DB scheme. DB schemes are rarer, and more valuable to the employee. They are generally found in the public sector and some large private sector employers. Often, they might have closed to new members.

C: COMPENSATION FOR A CLAIMANT WITH A DC PENSION

The loss to a claimant with a DC pension is generally assessed as the value of the contributions that the employer would have made to the pension pot if the claimant had not been dismissed. This may include contributions which would have been made in the period up to the remedy hearing, and also contributions which would have been made into the future. The employer's contributions are treated as if they were additional earnings.

Here is an example, taken from the Principles:

> Diane succeeds in a complaint of unfair dismissal. The hearing takes place six months after her dismissal. The tribunal decides that it will take her a further nine months to obtain an alternative position with equivalent benefits. She was employed at a salary of £30,000 per annum, but the tribunal is satisfied from the evidence it hears that that her salary would have increased to £35,000 three months after the hearing. Her employer contributed 5% of her salary into its DC pension scheme.
>
> The award of compensation to Diane in respect of the net pension loss arising from her unfair dismissal will be as follows:

Loss to hearing:	5% x £30,000 x 0.5 (6 months)		£750.00
Future loss:	5% x £30,000 x 0.25 (3 months)	£375.00	
	5% x £35,000 x 0.5 (6 months)	£875.00	
Total future loss:			£1,250.00
Total:			£2,000.00

In order to do this sort of calculation, the key information needed is **the percentage rate at which the employer contributed to the pension**.

The following information can also be useful in some cases:

(a) The percentage rate at which the claimant contributed;

(b) Whether the scheme contained any other benefits such as survivor or dependant benefits in the event of the claimant's death;

(c) The age at which the claimant can draw a pension from the scheme, and

(d) The current value of the invested funds (the 'pension pot').

Both the employer and the employee should be able to get this information from the pension provider.

If the claimant has a new job with pension rights the parties will also need the same information, but only the claimant will have access to that. It might be useful to ask the new employer for help in getting it. (If the claimant has a new job with DB scheme, different information will be needed, see below).

Each side should try to calculate what they say the relevant loss is, taking into account what would have happened in the old job (if not for the dismissal) and what has (or will) happen in any new job. The employer might also argue for compensation to be reduced due to (for example) contributory fault, or the chance that employment would not have continued to retirement anyway. These calculations should be included in the claimant's Schedule of Loss and any counter-schedule prepared by the respondent.

More information about DC pensions and calculating losses is in Chapter 4 of the Principles. Examples are given in Appendix 3 of calculations in simple and complicated DC cases.

D: COMPENSATION FOR A CLAIMANT WITH A DB PENSION

It is more difficult to work out the value of loss when the claimant has a DB pension. It will often be much higher than pension loss in a DC scheme, and may well form a very significant part of the overall losses. This is why, despite the difficulty, it is even more important that parties do not overlook it or leave it as an afterthought.

Sometimes it will be appropriate to assess the loss based on employer contributions (as discussed above for a DC scheme). This might be the case where, for example, the ET finds that the claimant would not have remained in that employment for very long, so the pension loss is small.

The parties should think about whether that might be an appropriate approach for their case, and be prepared to tell the ET what they think, and why.

In cases where a full DB calculation needs to be done, the parties will need to try to obtain the following information. Again, this should be done at an early stage and agreed as far as possible. The key information is:

(a) The type of DB scheme. That is, whether the pension based on final salary, career average revalued earnings ("CARE"), or some other basis[2];

(b) The claimant's likely retirement age (the parties may put forward different ages);

(c) The claimant's current projected pension income at retirement, and

(d) The claimant's projected pension income if they had continued to work in the old job until retirement.

In most cases the pension scheme administrators should provide this information if requested by either the claimant or respondent.

The following information may also be useful, especially if there are different possibilities for the claimant's retirement age, and projections are not available for all of them.

(a) The rate at which the claimant accrues rights as a proportion of final salary or CARE;

(b) The rate of employer contributions, whether actual or notional, (if possible as a percentage of salary);

(c) The rate at which the claimant contributed (if possible as a percentage of salary);

(d) Whether the scheme contained any other benefits such as survivor or dependant benefits in the event of the claimant's death, and

[2] Summaries of the main public sector DB schemes are provided in Appendix 1 to the Principles.

(e) The earliest age at which the claimant can draw a pension from the scheme.

Where the claimant has got a new job (or is likely to) the ET will also need to know the retirement income which will be generated by the new job. This means the claimant will need to get information about the new pension scheme as well (perhaps with help from their new employer). If the new scheme is a DC scheme, they should try to get a projection of the retirement income it is likely to produce. If that isn't possible, the Principles explain how it can be estimated.

The approach is then to work out the difference between what the claimant's annual retirement income would have been if they hadn't been dismissed, and what it will actually be. That gives an annual loss for each year of retirement (referred to as the **"multiplicand**").

This loss will occur each year the claimant lives on after retirement. Of course, we have no way of knowing how long that will be in an individual case. However, there are statistics available for general life expectancy. These figures are modified to reflect other factors (including that the ET compensation will be paid to the claimant much earlier than the pension would have been). The tables used for this are known as "the Ogden Tables". The precise figure in any specific case depends on the claimant's gender, their age at the date of the hearing, and their retirement age. It also depends on a figure prescribed by the Government from time to time reflecting how the value of money changes over time. This is known as the "discount rate". Using the Ogden table extracts set out in Appendix 2 to the Principles takes account of all these factors and produces a figure based on life expectancy after retirement known as the "**multiplier**".

The ET will multiply the multiplicand by the multiplier to produce a total figure for pension compensation.

The ET's calculation might adjust the pension loss to take account of "withdrawal factors". These are other events which might have affected the claimant's pension – for example if the claimant would have been made redundant at a later date, or would have taken time away from employment to fulfil caring responsibilities. Both parties should think in advance about any factors which might have affected the claimant's pension (aside from the dismissal) and produce evidence of those matters where available.

More information about DB pensions and calculating losses is in Chapter 5 of the Principles. In particular the 'Seven Steps Model' will take you through the process described above in more detail. You can also find more examples of DB calculations in Appendix 3.

E: TAX

Generally, all pension loss should be calculated using net figures.

However, because the compensation payment will be made as a lump sum, an extra amount will be added to account for the tax that will be payable by the claimant in the tax year in which compensation is received. This is called 'grossing up' and the idea is to leave the claimant with the same net amount of compensation once the tax has been paid.

There is more information about grossing up at the start of Appendix 3 to the Principles.

F: CONCLUSION

The idea of the Principles is that in most cases the parties will be able to do the calculation themselves. However, there may be some high value and complex cases where the parties will find it helpful to ask an accountant or actuary to help them. This will of course involve professional fees being incurred.

Sometimes, in cases involving a potentially high value loss, the ET may hold two remedy hearings to give the parties time to address the question of pension loss properly. Even if the claimant has been unrepresented in the case so far, it may be worthwhile using the sums awarded at the first remedy hearing to pay for professional advice on pension loss.

G: FURTHER INFORMATION

Here are some other useful resources:

The Pensions Advisory Service website. Especially this page about asking for information from your pension scheme.

The NEST online pension calculator can be used to provide projections of pension income from the auto-enrolment scheme.